

Audit's

MONTHLY NEWS ANALYSIS OF SECURITIES OF REAL ESTATE INVESTMENT TRUSTS

Realty Trust Review

For delivery Monday, June 28, 1971

VOL. II, No. 6

TRUST SHARES

Our model portfolios have moved in contrary directions during the past 30 days and no changes in holdings are recommended at the present time. Model portfolio reviews.....p.5

INDUSTRY NEWS AND STATISTICS

Automatic dividend reinvestment plans have been started by Cousins Mortgage and Equity Investments and, soon, by PNB Mortgage and Realty Investors. An assessment of the plans.....p.2

Earnings per share: accountants are revising their rules to make EPS reports less confusing to investors, and we introduce a new tally of interim reports by trusts.....p.4

Innovation and diversity and a general shift toward equity oriented trusts mark the latest new and proposed offerings.....p.7

TO SERVE YOU BETTER, AN INCREASE IN PUBLISHING SCHEDULES

Beginning with July issues, REALTY TRUST REVIEW will reach you twice monthly instead of once a month as at present. Under our new schedule we will be mailing issues on the second and fourth Friday each month to reach you the following Monday. The early month issue will primarily contain commentary and analysis while the second issue will be devoted primarily to statistics and market evaluation.

We are making the change with a double purpose in mind. First, we believe the expanding nature of the real estate trust securities markets makes it absolutely vital to reach investors more frequently. For many investors, the 12 pages of hard facts once a month makes difficult going. The monthly schedule will facilitate reading while serving the growing market needs with more immediacy. And second, it will smooth the peak work loads which have developed as a result of our expansion to 12 pages. These major peaks and valleys hamper our efforts to bring you in-depth coverage and analysis, while the twice-monthly schedule should aid these efforts.

There will be no change in subscription rates. Your continued comments on how we may better serve your needs are encouraged. Please also continue to send your specific questions about trusts so that we may reply for the benefit of all investors.

KENNETH D. CAMPBELL, EDITOR AND PUBLISHER / AUDIT INVESTMENT RESEARCH INC., 230 PARK AVENUE, SUITE 555, NEW YORK, N.Y. 10017 (212) 725-1410

AUDIT REPORT, REALTY TRUST REVIEW and special industry investment reports are published by Audit Investment Research, Inc., registered as an investment adviser with the Securities and Exchange Commission under the Investment Advisers Act of 1940. Under no circumstances is anything contained herein to be construed as an offer to purchase or a solicitation to sell any security mentioned. Information has been obtained from sources believed to be reliable and reasonable care has been exercised in compilation, but accuracy or completeness cannot be guaranteed. Expressions of opinion are solely the responsibility of the publisher and may be changed at any time without notice. Audit Investment Research will disclose any interest it holds in any security mentioned in an advisory publication, although its officers, employees or clients may from time to time have an interest in securities covered in its publications. Copyright 1971 by Audit Investment Research, Inc.

Published monthly with Comparative Trust Statistics on the fourth Friday Subscription \$84 annually Group rates on request

THE GREAT AUTOMATIC DIVIDEND REINVESTMENT PUZZLE

When Cousins Mortgage and Equity Investments first began offering its dividend reinvestment plan, it stirred a lot of comment that gradually has turned into controversy. PNB Mortgage and Realty Investors has announced its intention of following suit and a number of other realty trusts are known to be considering the move.

The Cousins plan is relatively simple in concept, although there are a host of housekeeping details that must be kept up to make the plan truly effective. Basically each shareholder of record can elect to receive dividends in either cash or shares of beneficial interest and will continue to receive such shares until he terminates the plan. The shares are issued or purchased at the lower of book value or market. A few operating details:

1. No certificates are issued until the shareholder terminates the plan. This allows the trust's agent, Bankers Trust Company, to issue fractional shares when dividend amounts do not round to full shares. When any shareholder terminates his plan, he receives a certificate for all full shares plus cash for the fractional shares.
2. The Agent charges the lesser of \$0.75 or 10% of the dividend for each distribution handled under the plan.
3. Distributions are fully taxable to shareholders upon crediting to their accounts and Bankers Trust renders a quarterly statement of amounts credited.
4. Shares issued under the plan are part of 200,000 shares registered by Cousins with the SEC in February and are fully tradeable upon the American Stock Exchange whenever the trust notifies the exchange they have been issued. Costs of this registration of about \$43,200 were paid by the trust.

The biggest point of controversy centers around the distribution of shares at the lower of cost or market. In practice the trust issues shares only at book value; if market price is below book value, the agent purchases shares in the open market. In Cousins' instance, for example, the book value was \$18.72 per share on the date of the first distribution April 12, 1971 while shares were trading from \$23.88 and \$25.75--or premiums ranging up to 37.5%.

Why should the trust sell shares below current market, goes the argument, for no clear benefit to shareholders? Or put another way, critics maintain the trust foregoes the potential benefit to all shareholders of practicing equity leveraging--i.e., selling new shares to new purchasers at prices higher than the book value contributed by existing shareholders. And there is no doubt that equity leveraging has been one main theme running through the thread of growth of older mortgage trusts like Continental Mortgage Investors and First Mortgage Investors.

But this very characteristic of the plan makes it attractive, say advocates. The shareholder accepting shares in effect receives a locked-in capital gain by being able to purchase shares below current market. He could, if he desires, sell them immediately, although in practice this is not done because of transaction charges on small lots. This built-in gain thus acts as an incentive for shareholders to participate in the plan and accumulate shares at costs below what they could buy in the open market. And if the share price remains above book value, the shareholder has his dividend taxed at lower capital gains rates.

When share prices dip below book value, the plan then provides some market support when it is most needed because the trust agent is instructed to make open-market purchases at the lower prices. And there is some discussion that trusts should go one step

further and make open market purchases any time the price dips below book value. These shares could then be accumulated in the treasury and reissued for future dividend reinvestment payments.

And there has been some discussion of paying such dividends only through open-market purchases, although it is frankly admitted that such a plan would have no attraction other than a possible savings of brokerage commissions.

From the standpoint of the trust itself, the plan lets the trust retain cash flow which would otherwise be distributed to shareholders and build a larger equity base by rewarding shareholders with the cheaper purchases. Book value per share would not be diluted in any way, but neither would it grow significantly over a longer term. And the plan is one viable alternative to the ban on outright stock dividends enforced by the Internal Revenue Service.

The management company obviously has much to gain by wide acceptance of a dividend reinvestment plan, since assets under management and thus the management fee would tend to grow larger. Such growth could in fact be quite rewarding to the manager while earnings per share--upon which the shareholders' total reward depends--could remain static.

Perhaps the best example of how an automatic dividend reinvestment plan works in practice is provided by the Madison Fund, a closed-end investment company listed on the New York Stock Exchange. Madison Fund is just completing a decade of experience under the plan begun in the middle of 1961. During that period total shares outstanding have risen from 7.2 million to 20.5 million, with about 3-3.5 million of these new shares having come from new offerings and exchange for smaller funds and the remainder from dividend reinvestments. Net assets have approximately doubled from \$150 million to \$292 million in the decade.

Since Madison, like other investment companies, invests in a portfolio of stocks, net asset value has tended to fluctuate rather widely, going from \$21.32 at the end of 1960 (before the plan) to a high of \$25.65 at the end of 1968 before falling to its most recent value of \$16.36 per share. During a large part of the 1960s the shares commanded a large premium over net asset value but in more recent times this has shriveled to a very small discount. For shareholders, this has meant that most shares purchased have been at prices below then-current market prices, thus providing them with the opportunity for capital gains.

About 23%-24% of shareholders now use the reinvestment plan for Madison's three regular quarterly dividends. In March of each year, Madison distributes all its capital gains for the prior year and for this quarterly payout makes the dividend reinvestment available without charge as an additional inducement for shareholders to accept. As a result nearly 80% of shareholders have opted for reinvestment in some recent years.

Madison management believes dividend reinvestment has been one key element in the maintenance of a market price over net asset value for most of this time, and in fact believes that the premium is rather crucial in the continuing attractiveness of the plan. The expense of constant SEC registration under the plan is rather minimal, and also serves to qualify the shares for purchase under Keogh plans and for exchange for smaller investment companies. All in all, management is enthusiastic about the plan.

From this we draw several conclusions. First, there is no easy "Yes" or "No" to the question of whether a given dividend reinvestment plan is beneficial or not. Much depends on what management does with the additional funds. If a small trust

uses dividend reinvestment to build its equity base and thereby opens new avenues for debt leveraging through commercial paper and bank lines, then the plan would be beneficial. If the managers merely collect a fee on more assets while earnings per share stagnate, then it will be a poor bargain indeed.

Second, there is a real question of workability for an equity trust. This is because book value--which is the base used in share purchases--rarely reflects the true value of an equity trust's assets, as it does for the financial-type mortgage REITs. Book value typically will decline slightly for an equity trust when depreciation charges exceed debt repayments. No equity trust has so far put a dividend reinvestment plan into effect.

Third, comparisons with closed-end investment companies should be taken with a grain of salt, since these companies invest in stock portfolios and thus their net asset value can fluctuate rather widely. Since book value and market prices for a realty trust tend to fluctuate within relatively narrow ranges, shareholders can gauge potential capital gains through dividend reinvestment somewhat more accurately than they could for an investment company.

It will be some time before all the pieces to the dividend reinvestment puzzle are fitted together. They still must be regarded as promising experiments, and as worked out by Cousins and PNB, are probably the best method of rewarding current shareholders without foregoing major opportunities for other expansion of funds by the trusts. On balance it appears share purchase plans might tend to moderate growth in earnings per share, but the evidence on this point is still meagre. The shares of trusts with such plans will be more attractive to persons seeking to establish long-term positions in these trusts than to investors oriented to more rapid capital appreciation.

ACCOUNTANTS BEND A BIT ON EARNINGS PER SHARE

The American Institute of Certified Public Accountants is making it known that the earnings per share calculations for real estate investment trusts will soon be changed. The net effect of the changes will be to make primary earnings per share depend heavily upon dividends distributed.

Under earlier rules laid down by the Accounting Principles Board, rules making body of the AICPA, many trusts with a large number of warrants outstanding were required to report primary earnings per share lower than the amount of their dividends. Investors generally were bewildered by such situations--a trust paying out more than it earned? The net result was that an APB opinion designed to enlighten investors and warn them of impending dilution created new layers of confusion instead.

The confusion became so great that in developing Comparative Trust Statistics for you earlier this year, we at REALTY TRUST REVIEW omitted for analytical purposes the fully diluted earnings per share numbers for trusts with large warrant issues and began using primary earnings for these trusts and fully diluted earnings for trusts with convertibles.

The new rules will end a great deal of the confusion and will essentially follow RTR's lead in distinguishing between potential dilution from warrants and convertibles. (We had no part in the discussions with APB, however.) This is to be done by deducting dividends paid or accrued before determining the effect of potential dilution. The accountants reasoned that since trusts pay a minimum of 90% of earnings to shareholders immediately, the money is gone and potential dilution could take place only on the small amount of funds remaining in the trust. This is quite unlike an industrial company, in

which earnings are retained.

The fully diluted earnings figures will however be calculated in approximately the same manner as at present, so in a number of instances investors will still be confronted with two widely varying earnings per share numbers. This is so because no other industry has financed itself through warrants like the real estate investment trust industry to date. Investors certainly need to be alerted to the potential dilution ahead, as well as the results of current operations. It is hoped that the revised method will move everyone closer to that goal.

With some clarification emerging in the earnings per share reports, we are beginning this issue a tabulation of all interim earnings reports issued by realty trusts since our last issue. To assist investors in evaluating results, we are reporting both primary and fully diluted share earnings for both the previous quarter (or six months if applicable) as well as the year-ago period. This should permit better evaluation of earnings trends and make computerized statistical data more meaningful.

RECENT EARNINGS REPORTS BY REALTY TRUSTS

Trust	Quar. ending	--Earn/sh.--		--Prev. per.--		--Year ago--	
		Prim.	Dil.	Prim.	Dil.	Prim.	Dil.
Hubbard	Apr.	\$0.40	--	\$0.41	--	\$0.41	--
Atico Mtg.	Apr.	0.51	NA	0.47	0.37	0.28	--
MassMutual M.	Apr.	0.37	--	0.30	--	NO	--
First Mtg.	Apr.	0.59	0.52	0.58	0.47	0.43	0.37
First Union	Apr.	0.32#	--	0.31#	--	0.30#	--
Cont.Mtg.	Mar.	0.29	--	0.28	--	0.21	--
Median Mtg.	Apr.	0.28	--	NO	--	NO	--
Guardian Mtg.	May	0.93	0.91	0.84	0.79	0.83	0.60
Western Mtg.	Feb.	0.17	--	0.15	--	0.14	--
Unionam.Mtg.	May	0.57	NA	0.51	0.42	0.35	--
Gould Inv.	Mar.6mo.	0.56	--	NA	--	0.25	--
Fidelco Gr.	May	0.66	--	0.60	--	NO	--
Hotel Inv.	May	0.44	--	0.38	--	NO	--
Cousins Mtg.	May	0.43	--	0.40	--	NO	--
First Mem.	May	0.44	--	0.40	--	NO	--
Chase Man.	May	0.89	0.81	0.64	0.59	NO	--
Nat.Mtg.Fd.	May	0.36	0.25	0.21	0.31	0.26	0.23
Mtg.Tr.Am.	May	0.57	0.42	0.56	0.43	0.49	--
M&T Mtg.In.	May	0.33	--	0.26	--	NO	--
Wachovia Rl.	May	0.61a	--	0.55	--	0.42	--
Palomar Mtg.	May	0.37	--	0.36	--	0.34	--
Real Es.In.	May 6mo.	0.74b	--	0.73	--	0.77b	--

a-After provision for loan losses of \$0.03/sh. b-Before capital gains. #-Gross cash flow before mortgage amortization. NO-Not operating. NA-Not available.

PORTFOLIO REVIEW: STILL TIME FOR CAUTION IN MARKET CROSS-CURRENTS

Our model portfolios have gone in opposite directions during the past month. The mortgage trust portfolio advanced about 3.5% (see below) while the long-term inflation hedge group declined about 3.2%.

The contrary currents reflect continued concern about the course of interest rates. Short-term rates have been moving upward in a zig-zag course, and trial balloons

for a higher prime rate of a month ago have been followed by rises in the prime to 5 3/4% and 6% by several large banks, including First of Pennsylvania of Philadelphia and Bank of California. But money center banks have been reluctant to follow suit, largely for fear that any increase will raise political storm warnings.

On the other hand, the bond market has backed off from yields in the 8.2% range that prevailed a month ago and the recent offering of Michigan Bell Telephone debentures was priced to yield 7.8%, where it encountered sales resistance. May's flare-up in the cost of living index to an annual rate of 6.0% gave a big push to pressures for higher yields.

On balance we still do not believe the business recovery has enough steam to support much higher rates in the long-term markets. The rise in short-term rates has brought the two back near their historical relationship. We still do not look for much major change in rates before year-end.

In this setting mortgage trusts have brighter near-term prospects, since the turnaround in rates effectively puts a floor under falling portfolio yields and indicates somewhat higher yields in the future. Well managed trusts with known leveraging and origination capabilities should continue to do very well. For the time being we are however adding dividends to our cash balances in the aggressive portfolio, in the belief that the general market uneasiness still has a way to run. The showing of our mortgage trust portfolio is impressive against the backdrop of a 3.5% decline in the Dow-Jones Industrials for the month. The Paine-Webber Index of mortgage trusts was up 6.1% in this span while the equity trust index was down 1.0%.

Equity trust shares are reacting because they cannot increase their yield as quickly as the short-term mortgage trusts. Interestingly, the more aggressive equity trusts gained strongly during the month, with General Growth Properties (our largest Portfolio I holding) up 12.4% for the month. Our portfolio position:

PORTFOLIO I LONG TERM, INFLATION PROTECTION						PORTFOLIO II INTERMEDIATE TERM, AGGRESSIVE					
Sh.	Issue-Ann. Div.	Orig. price	Mkt. 6/22	Mkt. val.		Sh.	Issue-Ann. Div.	Orig. price	Mkt. 6/22	Mkt. val.	
800	Gen.Growth -0.88	\$23.13	\$27.25	\$21,800		700	Alison Mtg.-2.16	\$21.00	\$20.50	\$14,350	
400	US Lsg. RE -1.08	22.13	19.38	7,752		400	Assoc.Mtg. -2.40	29.38	24.50	9,800	
700	Penn. REIT -0.85	12.50	11.63	8,141		300	Cont.Ill. -2.40	32.12	32.75	9,825	
750	Rlty.Inc.Tr-1.20	17.13	15.00x	11,250		450	Larwin MI -2.08	24.15	23.00	10,350	
600	Saul(B.F.) -1.24	19.75	16.88	10,128		300	Diver.Mtg. -2.04	29.13	27.75	8,325	
400	Wash. REIT -0.96	12.63	10.63x	4,252		200	Guard. MI -3.04	33.50	34.50	6,900	
600	GREIT Rlty -1.60	18.25	17.25	10,350		300	Grt.Amer.M -1.86	26.63	29.25x	8,775	
200	BankAm.Rlt.-1.40	28.75	25.63	5,126		200	First Mtg. -2.20	32.38	28.00x	5,600	
700	Mob.Hm.Com.-0.47	9.75	8.00	5,600		200	No.Amer.M -2.12	28.00	25.13	5,026	
300	Cabot C&F---New	22.00	21.63	6,489		100	Am. Cent. -2.12	26.00	24.63x	2,463	
	Mkt. value	\$97,355*		\$90,888		400	Fidelity M -2.00	20.00	20.25x	8,100	
								\$94,240*		\$89,514	

*Including transaction costs

Cash, beginning of mo.	\$ 2,986
Dividends received	636
New purchases-none	---
Cash, end of month	3,622
Net asset value	\$94,510
Net change in month	-3,123
% change	-3.2

Cash beginning of mo.	\$ 7,097
Dividends received	418
New purchases-none	---
Cash, end of month	7,515
Net asset value	\$97,029
Net change in month	+3,287
% change	+3.5

NEW TRUSTS AND REGISTRATIONS SHOW INNOVATION AND DIVERSITY

Flexibility denotes the recent entries and those which plan to come public. The innovative trend to which we have called attention earlier continues, with a larger proportion of the newer trusts taking part. The newer trust managements are taking full advantage by adapting their real estate expertise to changing markets. Some of the wiser, farsighted trust managements had drawn up their charters a long time ago with maximum flexibility of few predetermined limits on asset allocation. Equity of course is an overriding objective either in direct ownership or more often in a variety of participations. Where equity is not sought, higher yields are sought by accepting less than commensurate risk through sensible, knowledgeable deal-making. Conservatism for its own sake is out. There are no new trusts placing their equity in guaranteed loans. A little more daring is also being displayed in leverage. Several newcomers are able to leverage their equity up to 500%. Imaginative charters, while no substitute for professional acumen and opportunity, at least indicate that more groups are aware of greater possibilities and are striving for them.

Does this begin to seem a little reminiscent of the real estate wheeler-dealers of the early sixties? We do not think so. No doubt some are stretching for loans. By and large, however, the bulk of personalities today strike us as an aggressive breed that are striving for better-than-average yields rather than empires. Besides, management fees are a lucrative reward in themselves. One of the most disturbing aspects of new trust offerings and registrations is continued heavy reliance on dilutionary warrants.

Investors Realty Trust came public on April 29 with 1,200,000 shares at \$15. An offshoot of some the real estate activities of one of the largest private fortunes, the Phipps interests, the trust will invest primarily in equity and also in first mortgages. In fact, 44% of the proceeds from the offering will go into equity investments. Of the \$8.3 million being initially committed, \$4 million will go into a department store in Salt Lake City, Utah and most of the rest into two garden apartments. Land purchase-leasebacks will take the remaining \$925,000, the land to be used for shopping centers. Additionally, these funds are being leveraged 2.3 to 1. The short term mortgages will take 26% of the proceeds, \$5.1 million to finance three projects all at 10½% interest. The trust can also make permanent loans, development and land loans (up to 5% of total assets), and the standard variety of junior loans (up to 10% of assets).

The advisor is Investors Realty Advisory which is 80% owned by Crescent Properties and 20% by Phipps Land which has an option for another 20%. Together they bought 200,000 shares of the trust at \$13.65, \$2,730,000, concurrent with the public offering bringing in a gross total of \$20,730,000.

Donald MacLeod is managing trustee and president of the advisor. He is president of Crescent Properties with a real estate background from New York Life Insurance Co. Most of the other trustees have real estate backgrounds and include a former Tennessee governor, Buford Ellington. Address: Third National Bank Bldg., Nashville, Tenn. 37219 Phone: 615/259-2635.

Realty ReFund Trust sold 1,000,000 shares, each with one warrant, on June 17 for \$20, a gross of \$20,000,000. This trust will specialize in refinancing income producing properties as commercial, industrial and multi-family residential. In practice these will be mostly wrap-arounds but will also include land purchase-leasebacks and first and junior mortgage loans of varying maturities. The trustees do not intend to make construction mortgage loans, land loans or issue take-out commitments. The basis of its decisions is to be an operating record. A wrap-around loan

June 28, 1971

is a junior mortgage loan where the lender assumes the first mortgage and gives the borrower an amount equivalent to the first mortgage plus an additional amount deemed to reflect the added value of the property.

The trust will commit \$13,300,000 of its initial investments of \$14,800,000 to wrap-arounds at an effective yield of 11.96%. The rest will go into a land purchase-leaseback at an effective yield of 11.86%. Over half the wrap-arounds are for office buildings. The properties are located mainly in the Midwest. The land deal is in Miami Beach, Florida. Leveraging up to 400% of net assets is permitted and lines of credit for \$10,000,000 have been established.

The advisor is owned by four individuals through Mid-America Management Corp. Alfred Lerner is president of the advisor with six years listed in real estate and currently serving as chief executive officer of an electrical testing equipment firm. Another advisor officer is from Fraser Mortgage. Only some of the trustees have real estate backgrounds. Address: 1101 Euclid Ave., Cleveland, O. 44115. Phone: 216/771-4440.

USF Investors sold 2,000,000 shares, each with a warrant, for \$25 June 22, totaling \$50,000,000. This included 100,000 such units purchased by the parent, U. S. Financial which owns 91% of the advisor. This trust has one of the broadest charters which will permit investing in a diversified portfolio of mortgages and real estate investments and provide real estate developers with a broad range of financial borrowing services. To consist primarily of first mortgage development and construction loans on residential and commercial properties, activities will include back-to-back land development and construction, permanent, purchase-leaseback, net leasing, junior and wrap-around, equity investments and, where practical, participations will be sought. Additionally, the trustees may vary the portfolio and investment policy without shareholder approval. Land loans will be made with a view to appreciation. At least \$35,000,000 of the proceeds will be funded initially in 36 short-term construction and development loans to yield 11.18%. The trust may proceed then to its other goals drawing on \$19,000,000 bank lines which it has been offered. It can leverage up to 500% of its net assets.

The advisor is 91% owned by U. S. Financial which designs, produces, finances and sells housing. Activities cover a wide range of residential development and construction. Volume in 1970 was \$126 million. Much of its output stems from joint ventures with independent contractor and developers, a more speculative and tenuous way of doing business.

Robert Walter is chairman of the trust and advisor. He is chairman of U.S. Financial. Many of the trustees and officers of the advisor have extensive real estate experience including service with other trusts. Address: USF Investment Managers, (the advisor) 1090 N.E. 79th St. Miami, Fla. 33138. Phone 305/758-6961

Several interesting trusts are also in registration. Property Capital Trust is the first private trust coming public. It is a landmark in several respects. With book value of \$10.28, the maximum filing price is \$23. Address: Three Center Plaza, Boston, Mass. 02108. Phone: 617/742-9430.

Baird & Warner Mortgage and Realty Investors has registered 625,000 shares at \$20 with \$12,500,000 in convertible debentures, a total of \$25,000,000. This trust plans both construction loans and equity investments. Most of the trust's investments will be around metropolitan Chicago and surrounding Midwestern states. Address: 10 South La Salle St., Chicago, Ill. 60603. Phone: 312/236-1855.

Texas Mortgage Investors has registered 1,000,000 shares, each with a warrant, at \$20. The trust intends to invest primarily in construction and development loans in Texas and the Southwest. Address: 1919 Allen Parkway, Houston, Texas 77019. Phone: 713/529-3931.

Written as of noon Thursday June 24th.